

**Report On 2003 Franchise Tax Board Sponsored Legislation**  
**April 29, 2003**

<b>Bill No.</b>	<b>Status</b>	<b>Topic</b>
AB 1740	AR&T Committee	Child And Dependent Care Credit For Nonresidents And Part-Year Residents/ AB 1115 Clean-Up
AB 1742	AR&T Committee	Exemptions/Golden State Scholarshare Trust Technical Clean-Up/ Erroneous Refund Interest Computation Simplification And Conformity AB 2892 Clean-Up
AB 1743	AR&T Committee	Technical Changes
SB 1061	SR&T Committee	Water's-Edge Election Procedures/ Definition Of "Taxable Year" For Calendar Or Fiscal Years Beginning On Or After January 1, 2000
SB 1065	SR&T Committee	Prior Federal Elections And New California Taxpayers
SB 1066	SR&T Committee	Definition Of "Taxable Year" For Calendar Or Fiscal Years Beginning On Or After January 1, 2000

**LEGISLATION PRESENTED FOR BOARD POSITION**  
**April 29, 2003**

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2	AB 205 Amend 3/25/03	Goldberg	1	NIA	Filing Status/ Domestic Partners
3	AB 263 Amend 3/25/03	Oropeza	2	NIA	Dividends Received Deduction/ <i>Ceridian</i> Issue
4	AB 385 Intro 2/14/03	Nakano	5	N	State Agencies/ Provide Itemized Salary or Wage Statements in Writing or Electronically
5	AB 628 Amend 4/2/03	Runner	5	NIA	Withholding on Real Estate Interests/ Exempt Sole Proprietor
6	AB 735 Amend 3/26/03	Campbell	6	OUA	Taxpayer Privacy Bill of Rights Act/ Expands Scope of Taxpayers' Rights Advocate to Include Taxpayers' Privacy Rights
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8	AB 1338 Intro 2/21/03	Chavez	9	N	Withholding on California Real Estate/ 9.3%/ Escrow Person Liable for Penalty
9	AB 1567 Amend 4/10/03	Correa	10	NIA	FTB Investigators/"Peace Officer" Status
10	AB 1603 Intro 2/21/03	Bates	11	NIA	Exclusion/ Gain from Stock Option in High Technology Business
11	AB 1604 Intro 2/21/03	Bates	12	NIA	Military Rental Housing Property Tax Credit

12	AB 1690 Amend 4/1/03	Leno	13	Neutral, With concerns	Local General Income Tax/ Fire Protection Finance Agency Formed by Local Government
13	ABX 16 Intro 2/20/03	Goldberg	15	N	Mortgage Interest Deduction/ Decrease Amount from \$1M to \$500K
14	ACA 12 Intro 2/21/03	Leslie	15	N	Constitutional Amendment/ California Fiscal Responsibility & Taxpayer Protection Act
15	SB 25 Amend 3/6/03	Bowen	16	NIA	Personal Information/ Security of Social Security Numbers
16	SB 285 Intro 2/19/03	Speier	18	OUA	Relief From Joint and Several Liability On Joint Return
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19	SB 527 Intro 2/20/03	Vasconcellos	21	N	Economic Development Task Force/ Includes FTB Executive Officer
20	SB 640 Intro 2/21/03	Burton	22	NIA	State Agency Contracts/ Expatriate Corporations/ California Taxpayer and Shareholder Protection Act of 2003

(1)

**Bill No: AB 4      Author: Chan      Date: Amended April 3, 2003**

**SUBJECT: PIT Rates/ Increase Maximum Rates For Taxable Years Beginning on or After January 1, 2003 to 10% and 11%**

**DIGEST:** For taxable years beginning on or after January 1, 2003, this bill would:

- Reinststate the 10% and 11% personal income tax brackets
- Increase the AMT rate to 8.5%.

**COMMENTS**

**Purpose:** To increase revenue.

**ECONOMIC IMPACT (Revenue Gain in Billions)**

2003-04	2004-05	2005-06
+2.7	+2.1	+2.4

**Staff Recommendation:** Neutral

**Status:** Assembly Revenue and Taxation Committee

(2)

**Bill No: AB 205      Author: Goldberg      Date: Amended March 25, 2003**

**SUBJECT: Filing Status/ California Domestic Partners**

**DIGEST:** This bill would enact the California Domestic Partner Rights and Responsibilities Act of 2003. This bill would allow registered domestic partners to file their personal income tax returns as either married filing joint, or as married filing separate by applying the standards applicable to married couples under federal income tax law. In addition, this bill would add domestic partners to current law provisions regarding filing.

The bill also would make changes to the Family Code and the Government Code regarding registered domestic partners. These proposed changes would not impact the department.

**COMMENTS**

**Purpose:** To eliminate discrimination by giving domestic partners the same rights and benefits as married persons.

The department has identified the following implementation concerns:

- California personal income tax returns use the federal AGI to begin the calculation of state income tax. Since domestic partners would file separate federal tax returns, it is unclear what the federal AGI figure would be for domestic partners filing jointly on the state tax return.

- The department uses automated systems to compare taxpayer return information to files received from other state and federal agencies, including the Internal Revenue Service (IRS). Since domestic partners are required to file separate federal income tax returns and this bill would allow domestic partners to file a joint state income tax return, the department anticipates a significant delay in the ability of the automated systems to compare taxpayer information. The systems would need additional programming and testing prior to being operational.
- This bill states domestic partners may file either a joint return or file separately "by applying the standards applicable to married couples under federal income tax law." This bill could be construed to require domestic partners to file joint returns at the state level and no longer allow domestic partners to file single or married head of household returns at the state level. Although this treatment would be consistent with married couples, domestic partners who currently file as head of household typically pay less income tax than if they were to file as married, filing jointly.

**ECONOMIC IMPACT (In Millions)**

2003-04	2004-05	2005-06
-\$1	-\$5	-\$7.5

**Staff Recommendation:** Neutral, if amended

**Status:** Assembly Appropriations Committee

(3)

**Bill No: AB 263     Author: Oropeza**

**Date: Amended March 25, 2003**

**SUBJECT: Dividends Received Deduction/ *Ceridian* Issue**

**DIGEST:** This bill would repeal and reenact Revenue and Taxation Code section 24410 to allow taxpayers that own 80% or more of a subsidiary engaged in an insurance business a deduction for an unspecified percentage of dividends received from that subsidiary. The deduction would be allowed regardless of whether the insurance company is engaged in business in California. The deduction would apply to taxable years beginning on or after January 1, 2003.

For taxable years ending on or after December 1, 1997, and beginning before January 1, 2003, a taxpayer could elect to deduct an unspecified percentage of dividends received from an insurance company subsidiary. To make the election, the taxpayer must:

- timely file, within 180 days of the effective date of this bill, amended returns for all tax years within the period,
- expressly elect to be subject to the dividend received deduction and the percentage provided by statute, and
- report and remit all amounts due pursuant to the election.

For purposes of determining taxable income for the taxable years for which an election could be made (beginning on or after December 9, 1997, and before January 1, 2003), taxpayers would not be required to add back to earned income expenses related to section 24410 dividends. The election would not be revocable once made and would apply to all taxable years within the period.

### **COMMENTS**

**Purpose:** To resolve questions regarding how to apply the statute allowing a deduction for dividends received from an insurance company since that statute was found to be unconstitutional.

### **Ceridian Case**

The taxpayer in *Ceridian* challenged the limitation on the deduction for dividends received from insurance company subsidiaries set forth in RTC Section 24410 on two constitutional grounds relating to discrimination against interstate commerce. First, Ceridian was denied the deduction because the corporation was domiciled outside of California. Second, Ceridian argued that it was unconstitutional to limit the deduction to dividends paid only from income arising from California activities.

The California Court of Appeal ruled that the deduction for dividends received by holding companies from insurance company subsidiaries under RTC Section 24410 is unconstitutional on both grounds. First, it violated the commerce clause by allowing a deduction for insurance company dividends only to corporations domiciled in California. Second, it violated the commerce clause because the amount of the deduction is limited according to a formula based on the subsidiary's gross receipts, payroll, and property within California.

The Legislative Counsel of California issued an opinion on December 7, 2001, finding that Section 24410 is inoperative and unenforceable as a result of *Ceridian*. The Legislative Counsel concluded that the provisions of Section 24410 could not be severed to eliminate the unconstitutional provisions and leave a 100% deduction for dividends received from an insurance company subsidiary. Thus, no deduction would be allowed.

### **Department Policy After Ceridian**

Department staff is implementing the *Ceridian* decision in a manner consistent with the Legislative Counsel opinion that no deduction is allowed.

For tax years ending prior to December 1, 1997, the normal four-year statute of limitations is now closed. The department will apply RTC Section 24425 to deny expenses related to earned income that was not included in the measure of tax.

For tax years ending on or after December 1, 1997, the department will disallow all Section 24410-dividend deductions. A corresponding adjustment will be made if the taxpayer added back to earned income expenses related to the Section 24410 dividend deductions as provided by Section 24425.

**This bill**

There is some uncertainty regarding the election that could cause disputes between taxpayers and the department if the election is not clarified. Clarification is needed for the following issues:

- The election applies to taxable years ending on or after December 1, 1997, and beginning before January 1, 2003. It is unclear whether this election overrides the normal statute of limitations. For example, if the 1998 tax year is closed by normal statute of limitations, can a taxpayer make this election? Would the requirement that an amended return be filed within 180 days of the enactment of this bill override the normal statute of limitations for the 2002 tax year?
- It appears the taxpayer must make the election for all years between 1997 and 2003. However, the bill requires a separate amended return for each year. Perhaps the election should be made in the form and manner required by the Franchise Tax Board.
- Failure to remit the full amount of tax underpayment would void the election. It is unclear whether this would include penalties and interest.

Currently, there is a case before the Board of Equalization that once decided would clarify whether the result of the Ceridian decision is 100% deduction or no deduction. It is unclear whether the case or this bill would be controlling.

This bill, sponsored by industry, would specify that section 24423 does not apply for taxable years ending on or after December 1, 1997, and beginning before January 1, 2003. It would impact two cases currently on appeal at the BOE; one case with a California domiciled parent and the other with a parent domiciled in another state.

**ECONOMIC IMPACT**

The revenue implications of this bill depend on whether the current baseline is a 100% deduction for dividends received from an insurance company subsidiary or no deduction is allowed. It is assumed that current law does not provide a deduction for any taxpayer under RTC Section 24410. As the percentage of dividends received deduction is not yet specified in the bill, revenue losses for open (1997-2002) and ongoing tax years cannot be quantified at this time. However, if the current baseline reflects a 100% deduction, there could be undetermined revenue gains.

**Staff Recommendation:** Neutral, if amended

**Status:** Assembly Revenue and Taxation Committee – Suspense File

(4)

**Bill No: AB 385    Author: Nakano    Date: Introduced February 14, 2003**

**SUBJECT: State Agencies Provide Itemized Salary or Wage Statements in Writing or Electronically**

**DIGEST:** This bill would allow a state agency to provide each employee the option to receive the itemized statement of deductions made from his or her salary or wages electronically.

**COMMENTS**

**Purpose:** To provide state employees that participate in the Direct Deposit program an option to receive earning statements electronically. This would provide a cost savings to the state and help reduce paper use.

**ECONOMIC IMPACT**

This bill would not impact the state's income tax revenue.

**Staff Recommendation:** Neutral

**Status:** Assembly Appropriations Committee - Suspense File

(5)

**Bill No: AB 628    Author: Runner    Date: Amended April 2, 2003**

**SUBJECT: Withholding on Sale of California Real Estate Not Required if from Sole Proprietor of Residential House Construction Trade or Business**

**DIGEST:** This bill would exempt an individual from the 3<sup>1/3</sup>% real estate withholding requirement if:

- (1) the individual selling the property is a general contractor licensed to operate as a sole proprietor in the trade or business of construction and sale of residential houses, and
- (2) the real property disposed of was held by the seller for sale to customers in the ordinary course of the seller's trade or business.
- (3) the transferor executes a written certificate that he or she is a general contractor licensed to operate as a sole proprietor.

**COMMENTS**

**Purpose:** To clarify that the intent of the real estate withholding enacted last year be limited to non-business sale transactions.



This bill would raise the following implementation considerations:

- Builders may be involved in more than one construction-related trade or business. It is unclear if the individual will have to build the home to be exempt from withholding. Additionally, it is unclear if a builder that constructs office buildings, who is also in the trade or business of building residential houses, would be exempt from withholding in regards to a sale of an office building. Homebuilders also sometimes buy large tracts of land with one or more single-family residences on the property. If the homebuilder subdivided the tracts, sold the single-family residences, and developed the remaining parcels, it is unclear whether the individual would be exempt from withholding on the resale of the existing single-family residences.

### **ECONOMIC IMPACT**

2003-04	2004-05	2005-06	2006-07
-\$1	Negligible loss+	Negligible loss+	Negligible loss+

\* + Less than \$250,000.

**Staff Recommendation:** Neutral, if amended

**Status:** Assembly Revenue and Taxation Committee – Suspense File

(6)

**Bill No:** AB 735     **Author:** Campbell

**Date:** Amended March 26, 2003

**SUBJECT:** Taxpayer Privacy Bill of Rights Act/ Expands Scope of Taxpayers' Rights Advocate to Include Taxpayers' Privacy Rights

**DIGEST:** This bill would establish the Taxpayer Privacy Bill of Rights. Specifically this bill would:

- Expand disclosure laws that prohibit the disclosure of return information to prohibit FTB officers or employees from releasing a taxpayer's personal or financial information to the general public, unless a compelling interest is shown by FTB and the courts authorize the disclosure. Unauthorized release of, or threat to release, this information for the purposes of coercing a settlement of the taxpayer's state tax liability would be grounds for termination or other disciplinary action, regardless of whether the release or threat to release the information was express or implied, intentional or negligent.
- Prohibit an FTB officer or employee from presenting a taxpayer's personal or financial information to a court or administrative agency in connection with any court or administrative proceeding unless all of the following are satisfied:
  1. The taxpayer's personal or financial information submitted by FTB is limited to that information that is essential to an issue or issues in the court or administrative proceeding.
  2. FTB has shown a compelling need for the submission of the information.
  3. The Information is filed under seal from the public.

- Add a new cause of action allowing a taxpayer who has sustained damages as a result of any unauthorized release of, or threat to release, the taxpayer's personal or financial information rather than return information, to pursue an action for damages against FTB, its officers, or employees.

This bill also would expand the Taxpayers' Rights Advocate's authority to review and resolve taxpayer complaints to specifically include complaints regarding the unauthorized release of taxpayers' personal and financial information to the general public by FTB officers or employees. The Advocate would verify that the board takes appropriate disciplinary action against any officer or employee who violates a taxpayer's privacy rights.

In addition, this bill would expand the Advocate's authority regarding staying actions to include the tolling of any penalties and interest.

## **COMMENTS**

**Purpose:** This bill is intended to protect taxpayer privacy.

This bill does not define the phrase "a taxpayer's personal or financial information" or the terms "general public," "threat," or "essential."

This bill prohibits disclosure of certain information to the general public, unless authorized by the courts. This could be interpreted to prevent the department from contacting third parties without prior court approval. This could prevent the department from obtaining information necessary to determine the residency of a taxpayer. It could also hinder the department from obtaining information from a reliable source when a taxpayer refuses to provide requested information or when the department is verifying information provided by the taxpayer. If the department were required to seek authorization from a court before contacting any third party, the audit program would be significantly impacted. Audits would take longer and cost more to conduct. The bill would also impact the department's criminal investigations program since it is unclear whether the department could subpoena third parties. Further, this bill could delay collection of taxes if the department is required to obtain permission from a court before issuing orders to withhold, issuing liens, or using any other collection method that involves third parties.

This bill would require the entirety of a taxpayer's personal or financial information to be sealed in a court or administrative proceeding. Sealing records of any kind is a legal and public policy decision—made on a case-by-case basis—and already reserved for a judge under existing law. Also, sealing information as provided by this bill conflicts with other provisions of the tax law that allow disclosure of a return or return information in a judicial or administrative proceeding pertaining to tax administration. It would also conflict with statutes that specifically provide for the disclosure of certain information in certain circumstances (e.g., parent locator service or legislative committee).

This bill contradicts California's existing public policies and laws that judicial and administrative proceedings be public. A taxpayer's personal and financial information would be the subject of any tax proceeding. Under this bill, department staff could not advocate California's position in any forum unless the process was closed to the general public, or the department has first obtained authorization to disclose this information from a court. This could increase costs such as cost to defend against a taxpayer's appeal or suit for refund.

This bill would restrict the information that FTB can present in a court or administrative proceeding to information essential to an issue or issues in that proceeding. This could result in disputes between taxpayers and the department regarding what information is essential, especially in residency or unitary cases where substantial detailed information involving personal, financial, and business operations of the taxpayers are obtained during the audit and that information is relevant to issues in dispute.

Further, by restricting personal or financial information submitted by FTB in a judicial or administrative proceeding to only that which is essential, this bill would establish a new rule of evidence for the admissibility of evidence, seemingly in addition to the relevance standard, in judicial and administrative proceedings where the FTB is a party.

#### **FISCAL IMPACT**

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved. Audit activities that are dependent upon factual development, such as residency and unitary business audits, and collection activities, would likely be stopped while staff pursued court orders to obtain third party information. Department costs could increase for audit, legal, and collection activities as a result of this bill.

#### **ECONOMIC IMPACT**

This bill would have a significant, negative impact on State income revenues easily exceeding \$500 million annually beginning January 1, 2004.

The department sets up over \$780 million annually in assessments from audits to individuals and corporations. Based on the percentage of assessments and the dollar amount of those assessments that could be impacted by this bill, it is projected that this bill would impact assessments in the range of \$350 million to \$450 million annually.

In addition, the department sends out over 61,000 individual levies monthly to banks, credit unions, savings and loans and employers to collect over \$400 million in cumulative taxes owed. If the department were required to obtain a court order for each one of these levies, these activities would be delayed and may be put at risk.

**Staff Recommendation:** Oppose, unless amended

**Status:** Assembly Revenue and Taxation Committee

(7)

**Bill No: AB 986 Author: Horton**

**Date: Introduced February 20, 2003**

**SUBJECT: Legislative Analyst Conduct Study of Consolidating FTB's, BOE's & EDD's Remittance Processing, Cashiering & Mail Processing Functions**

**DIGEST:** This bill would require the Legislative Analyst to study and report to the Legislature regarding the consolidation of specific functions and operations of the Franchise Tax Board, State Board Of Equalization, and the Employment Development Department.

**COMMENTS:** This bill would not impact the department's programs and operations or state income tax revenue.

**Staff Recommendation:** Neutral

**Status:** Assembly Appropriations Committee

(8)

**Bill No: AB 1338 Author: Chavez**

**Date: Introduced February 21, 2003**

**SUBJECT: Withholding on California Real Estate/ 9.3%/ Escrow Person Liable for Penalty**

**DIGEST:** This bill would change the California real estate withholding requirements by:

- Allowing the seller to elect to have the maximum tax rate (presently 9.3% for individuals and trusts and 8.84% for corporations) of the gain withheld instead of 3<sup>1/3</sup>% of the sales price. The seller must certify under penalty of perjury that gain reported to the buyer or REEP is correct.
- Requiring withholding at maximum tax rate on the portion of any gain from the sale of a principal residence that is not excluded under IRC Section 121. This would normally mean gains in excess of \$500,000 for married individuals or \$250,000 for single individuals.
- Revising the withholding requirements on corporations with no permanent place of business in California to match the requirements for individuals. This eliminates the corporation waiver process and replaces it with the same statutory scheme in present law for self-certification by individuals.
- Making the real estate escrow person equally and severally liable for real estate withholding. Presently, if the real estate escrow person (REEP) informs the buyer of the withholding requirements, the REEP no longer has any liability for withholding.
- Removing the provision that prohibits a penalty from being assessed (would now allow the penalty) on the REEP for failure to properly withhold if the seller reports the gain on the sale of the property and pays the proper amount of tax by the due date or extended due date of the tax return.
- Clarifying expressly that transfers of real property will not be subject to withholding if they are contributions to capital of controlled corporations and partnerships, sales by estates of a decedent's principal residence, or other sales that do not result in a net recognized gain.

**COMMENTS**

**Purpose:** To modify the real estate withholding provisions so the withholding more closely matches the actual tax due on the sale of the property.

**ECONOMIC IMPACT: This bill would result in cash flow losses as follows:**

(In Millions)			
	2003-04	2004-05	2005-06
1. W/H at 9.3% on Gains from Sales of Non-Principal Residences	-\$30	-\$3	-\$3
2. W/H on Taxable Gain of Principal Residences	+\$20	+\$2	+\$2
Total	-\$10	-\$1	-\$1

**Staff Recommendation:** Neutral

**Status:** Assembly Revenue and Taxation Committee

(9)

**Bill No:** AB 1567 **Author:** Correa

**Date:** Amended April 10, 2003

**SUBJECT:** FTB Investigators/"Peace Officer" Status

**DIGEST:** This bill would:

- Specify that in addition to the introductory Peace Officer Standards and Training (POST) course, certain peace officers, including FTB investigators, must also complete the POST Specialized Investigators Basic Course within six months of being hired;
- Specify that certain peace officers, including FTB investigators, must successfully complete required firearms training, and must requalify in firearm use at least every six months or less as directed by the employing agency;
- Specify that the replaced classifications would remain operative in parallel to the new classifications until July 1, 2006, at which time the replaced classifications would be repealed, and only the new classifications would remain operative;
- Add intent language acknowledging that terrorism is a new domestic threat for which the state must be prepared and provide a means by which the Governor can utilize trained peace officers to prevent and combat terrorist threats or other emergencies by using already deployed public safety resources.

**COMMENTS**

From January 1, 2004, through June 30, 2006, FTB investigators would be subject to two separate and conflicting code sections. As a result, it is unclear which section would prevail.

If incumbent FTB investigators are required to take additional training, the 15-week period that the investigators would be required to be away from the department could impact FTB's enforcement of the Revenue and Taxation Code, and as a result FTB's ability to collect certain income tax revenues.

This bill changes the Penal Code section that lists FTB investigators as peace officers. Government Code section 20391(e) provides for the retirement benefits of FTB investigators by reference to the Penal Code section under which FTB investigators are currently classified. To avoid any issues with FTB investigator retirement benefits, this section should be amended to reflect the Penal Code section changes proposed by this bill.

**ECONOMIC IMPACT**

This bill would not significantly impact costs for this department.

**Staff Recommendation:** Neutral, if amended

**Status:** Assembly Public Safety Committee

(10)

**Bill No: AB 1603 Author: Bates**

**Date: Introduced February 21, 2003**

**SUBJECT: Exclusion/ Gain from Stock Option in High Technology Business**

**DIGEST:** This bill would exclude from gross income any gain from the acquisition, sale, or exchange of a stock option in a "qualified high technology business" located in California. This bill states that "qualified high technology business" shall be defined by law but does not provide the definition.

**COMMENTS**

**Purpose:** To encourage investment in the high tech sector.

Without a definition of the term "qualified high technology business," the department would not be able to implement this bill.

The bill requires that a "qualified high technology business" be located in California. The term "located" needs to be defined. In addition, the terms "acquisition" and "exchange" need to be specifically defined in order to determine which stock transactions are covered by the exclusion provided by this bill.

The exclusion provided by this bill is limited to gain from transactions relating to the stock option itself and not gain resulting from the acquisition, sale, or exchange of the stock of the qualified high technology business. The author may want to clarify whether the gain from the exercise of a stock option in a qualified high technology business is excluded by this bill.

**ECONOMIC IMPACT**

The revenue impact of this bill is estimated to be a revenue loss in excess of \$1 billion per year beginning with the fiscal year of 2003/04. Stock options treated as wages account for most of the revenue impact.

**Staff Recommendation:** Neutral, if amended

**Status:** Assembly Revenue and Taxation Committee

(11)

**Bill No: AB 1604 Author: Bates**

**Date: Introduced February 21, 2003**

**SUBJECT: Military Rental Housing Property Tax Credit**

**DIGEST:** This bill would allow a 100% credit for property taxes paid or incurred during the taxable year by a taxpayer that are attributable to rental housing that is occupied by a member of the armed forces and their family. Any credit that exceeds the taxpayer's tax liability could be carried over indefinitely. This credit would be repealed as of January 1, 2010.

**COMMENTS**

**Purpose:** To provide an incentive to rental property owners to continue to rent, begin to build, or otherwise provide homes to military personnel and their families.

This bill uses terms that are undefined, i.e., "attributable," "accommodate," and "rental housing."

It is unclear if the members of the armed forces need to be on active duty or whether members in the reserves would qualify. The bill should clarify if the term "their families" means members of the armed forces and their immediate family, i.e., spouse and dependent children, or relatives that reside in their household.

The bill uses the term "members of the armed forces." In order to provide consistency with existing law, the bill should be amended to instead refer to the federal and state term "members of the Armed Forces of the United States."

Generally, credits are provided as a percentage of amounts paid or incurred. This bill would allow a 100% credit, which is unprecedented. In addition, if a 100% credit is intended, it may be more efficient to instead allow a property tax offset instead of an income tax credit.

This bill would allow a rental housing owner to claim an income tax credit for the real property tax, which is already deductible from the income tax. Thus multiple tax benefits would be provided for the same item of expense.

This credit would not be limited to property in California. A taxpayer that pays property tax and rents that property to a member of the armed forces anywhere in the world and owes California tax could claim the credit.

**ECONOMIC IMPACT (In Millions)**

2003-04	2004-05	2005-06
-10	-225	-185

**Staff Recommendation:** Neutral, if amended

**Status:** Assembly Revenue and Taxation Committee

(12)

**Bill No: AB 1690 Author: Leno**

**Date: Amended April 1, 2003**

**SUBJECT: Local General Income Tax/ Fire Protection Finance Agency Formed by Local Government**

**DIGEST:** This bill would allow any city, county, or city and county to form a fire protection finance agency by ordinance. In addition, this bill would allow any city, county, or city and county that has formed such an agency to levy a general tax for each taxable year on or after January 1, 2004, on the taxable income of any person residing in the city, county, or city and county where the agency was formed.

- The tax may not exceed an amount equal to the net tax multiplied by:
  - 8% for a tax levied by a city,
  - 2% for a tax levied by a county, or
  - 10% for a tax levied by a city and county.
- The tax would be administered and collected by the “board” (see “Technical Consideration” below) in the same manner as personal income taxes.
- The taxes collected minus the costs of administration must be remitted within 60 days after those revenues are reported and collected.

Any ordinance or resolution adopted by a city, county, or city and county for the purpose of levying a tax on income would not become effective unless approved by a majority of the voters at an election. Upon approval of the tax, the city, county, or city and county must give notice of such approval to FTB. Within 60 days of the notice of approval, FTB must estimate the amount of tax to be collected in the first 12 months in which the tax is imposed and notify the county auditor.

**COMMENTS**

**Purpose:** To allow cities and counties to fund additional fire protection services.

The department has identified numerous implementation considerations, including the following:

- It is unclear whether the author intends for FTB to:
  1. process the PIT returns, calculate the local income tax for the appropriate taxpayers, and issue a notice of tax due to those taxpayers,
  2. include lines on the PIT return allowing the taxpayers to self-assess the local general tax while they are completing their PIT return, or
  3. amend the PIT booklets to include a separate local general tax form or schedule.

However, none of the current PIT forms have enough room to accommodate a local income tax. It is anticipated that the department would need to create a separate schedule to accompany the return.



- Under the current tax forms design schedule, the design, printing, and distribution of forms and booklets takes place in the fall of the actual taxable year. Once the voters approve a local general tax, this bill requires FTB to notify the county auditor of the estimated tax to be collected in the next 12 months. Assuming the author intends for individuals to self-assess the local general tax, and assuming an ordinance were passed in November 2004, the returns and booklets for the 2004 tax year would likely have begun printing and distribution.
- The PIT automated system is developed and designed to collect and process only PIT. It currently cannot administer two different tax structures separately within one taxpayer account. The existing automated system will not readily be able to separate the penalties and interest attributable to the local income tax. This would require a major redesign of the PIT system and potentially disrupt PIT revenue collection.

### **FISCAL IMPACT**

It is anticipated that significant implementation costs would be incurred to develop, test, and implement the changes that would be required to accommodate this bill. These start-up costs are not yet known, but would include system programming, creation of a billing system, and the creation of a schedule, form, or billing notices for the general tax.

The costs to administer this program are also not known. Total ongoing costs would depend upon the number of cities, counties, or cities and counties that would participate, the number of residents subject to the tax, the level of self-assessment and compliance achieved, and the extent of the enforcement activities needed. Costs would include additional storage space, data entry, system programming and maintenance, reports, collections activities, and customer service personnel.

The bill does not include a provision to cover FTB's start-up costs. Depending on when voters approved such a tax and how many cities, counties, or cities and counties approve such a tax, the costs could be more than one or two such areas could be expected to pay.

### **ECONOMIC IMPACT**

This bill would not impact the state's income tax revenue.

**Staff Recommendation:** Neutral, with concerns

**Status:** Assembly Local Government Committee

(13)

**Bill No:** ABX 16    **Author:** Goldberg

**Date:** Introduced February 20, 2003

**SUBJECT:** Mortgage Interest Deduction/ Decrease Amount to \$500,000 and \$250,000

**DIGEST:** This bill would reduce the maximum amount of acquisition indebtedness used in 2003 and later years to determine the deductible qualified residence interest amount for that year from \$1 million (or \$500,000 in the case of married person filing separately) to a maximum of \$500,000 (or \$250,000 in the case of married person filing separately).

**COMMENTS**

**Purpose:** To increase state revenue.

When the maximum acquisition indebtedness of \$1 million (or \$500,000 in the case of married persons filing separately) was enacted under federal it included “grandfathered debt” rules to allow taxpayers who had acquired a mortgage before October 13, 1987, to continue to deduct that interest in full. This bill would not change the “grandfathered debt” rules and, thus, the interest on those old mortgages would still be deductible in full even though those mortgages exceed the newly reduced maximum amounts.

This bill may be viewed as inequitable because it does not contain any “grandfathered debt” rules for mortgages acquired after October 13, 1987, and before this law is enacted in 2003.

**ECONOMIC IMPACT (Revenue Gain In Millions)**

2003-04	2004-05	2005-06
+\$380	+\$290	+\$300

**Staff Recommendation:** Neutral

**Status:** Assembly Desk

(14)

**Bill No:** ACA 12    **Author:** Leslie

**Date:** Introduced February 21, 2003

**SUBJECT:** California Fiscal Responsibility And Taxpayer Protection Act

**DIGEST:** This measure would amend the California Constitution to:

1. Limit the total increase in state revenues through the imposition of new or increased taxes, new or increased fees, or any other means of raising revenue during a calendar year. The increase may not exceed the previous year's percentage increase in the Consumer Price Index or comparable data for California.
2. Provide that an increase in General Fund spending during a calendar year may not exceed the previous calendar year's spending by more than the percentage increase in California personal income from the previous year.
3. Remove the requirement that 50% of the excess revenues received by the State in a fiscal year must be returned by the State by revising tax rates or fee schedules within the next two subsequent fiscal years.

4. Provide that 50% of the excess revenues received by the State in a fiscal year would either be 1) returned to California taxpayers by a means determined by the Legislature, or 2) placed in reserve for appropriation by the Legislature in future years.

In addition, this measure would provide that the Legislature may provide an exemption from or suspension of numbers 1, 2, or 4 above without submitting the measure to the voters of California. Instead, the Legislature could pass a bill in each house by roll call vote entered into the journal, three-fourths of the membership concurring.

#### **COMMENTS**

**Purpose:** To create a system to protect taxpayers and increase fiscal responsibility by limiting tax and fee increases and allowing the Legislature to determine the means by which excess revenues are returned to taxpayers.

As written, this measure would not have an immediate impact on the department. Any impact would depend on the means prescribed by the Legislature to return excess revenues to California taxpayers and whether the Franchise Tax Board would be required to be involved in that process.

#### **FISCAL IMPACT**

This measure would not impact the department's programs and operations.

#### **ECONOMIC IMPACT**

This measure would not impact personal income tax and corporate tax revenues.

**Staff Recommendation:** Neutral

**Status:** Assembly Committees on Revenue and Taxation and Constitutional Amendments

(15)

**Bill No:** SB 25      **Author:** Bowen

**Date:** Amended March 6, 2003

**SUBJECT:** Personal Information/ Security of Social Security Numbers (SSNs)

**DIGEST:** Under the California Civil Code, beginning on or after January 1, 2004, this bill would add state and local agencies to those persons that are restricted from using SSNs. Specifically, this bill would prohibit a state or local agency from:

- publicly posting or displaying an individual's SSN;
- printing an individual's SSN on any card required to access products or services;
- requiring an individual to transmit his or her SSN over the Internet unless the connection is secure or the SSN is encrypted;
- requiring an individual to use his or her SSN to access an Internet website unless a password or unique personal identification number is also required to access the website; and

- printing an individual's SSN on any materials that are mailed to the individual, unless state or federal law requires the SSN to be on the document to be mailed. Notwithstanding this provision, applications and forms sent by mail may include SSNs.

Further, this bill would create an exemption for state or local agencies that is similar to an exemption under current law for persons or entities. Specifically, this bill would allow a state or local agency, which has used an individual's SSN before January 1, 2004, in a manner inconsistent with the prohibitions, to continue using that individual's SSN in that manner after January 1, 2004, if the certain conditions are met.

### **COMMENTS**

**Purpose:** To make SSNs more confidential.

As drafted the department would be unable to implement this bill by January 1, 2004. An Amendment has been provided at the request of the author's staff to give FTB a three-year extension on the implementation date of this bill. Therefore, FTB would be required to implement by January 1, 2007.

The author's office has indicated that it is not its intent to require FTB to cease using SSNs as identifying numbers. The author may wish to provide an exemption for FTB or specify that this provision would not apply to FTB to the extent needed to fulfill its statutory obligations.

As stated above, the author's office has indicated that the intent of this bill is to restrict the department's ability to include SSNs on documents mailed to taxpayers. Therefore, the department further analyzed the bill under the assumption that the department would not be able to use the exemption.

A definition is needed for the term "administrative purposes." State agencies could be required to remove the SSN from personnel documents, unless the term administrative purposes was clearly defined to include employee-related matters.

- The department mails documents such as garnishments and levies to third parties such as a taxpayer's bank, employer, or landlord. Absent a clear definition of individual, the department would continue to send garnishments and levies containing the individual's SSN to these third parties.
- Modification to the Personal Income Tax (PIT) mainframe and related computer systems would be necessary to implement this bill. Since any implementation plan would require extensive system programming, testing, and processing, as discussed below under "Departmental Costs," the department could not fully implement this provision of the bill by January 1, 2004.

### **FISCAL IMPACT**

Staff is uncertain how this bill would be implemented and costs cannot be determined until implementation concerns have been resolved. However, if the department is required to remove SSNs from notices mailed to the taxpayer, cost estimates range from \$1.5 million to \$1.75 million. This estimate includes costs resulting from increased customer service contact, processing hours, programming, testing, and maintaining departmental systems.

The department may be able to continue using the SSN on documents mailed to taxpayers if the department were able to utilize exemptions under this bill. This estimate does not include the costs to meet the conditions of the exemption. Until the department receives clarification, the costs for this provision cannot be determined.

To ensure the department has the funding to implement this bill, the department would suggest the author add appropriation language to this bill that would cover the full costs of implementation. At a minimum, department staff suggests appropriation language that would provide FTB \$540,000 for the 2003/2004 fiscal year.

**Staff Recommendation:** Neutral, if amended

**Status:** Senate Appropriations Committee – Suspense File

(16)

**Bill No: SB 285     Author: Speier**

**Date: Introduced February 19, 2003**

**SUBJECT: Relief From Joint and Several Liability on Joint Return**

**DIGEST:** This bill would provide a rebuttable presumption that if an individual receives income tax relief under the federal innocent spouse provisions, that individual would also receive income tax and penalty relief under the state innocent spouse provision.

Under this bill, once an individual requests innocent spouse relief from FTB it would be presumed that the facts and circumstances that lead to the favorable federal innocent spouse relief determination would be sufficient to grant innocent spouse relief at the state level, unless the presumption is rebutted with evidence contrary to the facts and circumstances that lead to the federal conclusion. If the presumption is rebutted, FTB staff within the Innocent Spouse Program would make a separate innocent spouse determination on the merits of the evidence presented. If the presumption is not rebutted, the taxpayer is granted innocent spouse relief for state income tax purposes.

**COMMENTS**

**Purpose:** To allow taxpayers who request innocent spouse relief at the state level to receive the same determination that was received at the federal level.

Requiring the department to grant innocent spouse relief based on a federal determination would prevent the department from making a separate determination based on all the facts and circumstances available to the department, which would be unprecedented.

The department suggests clarifying the procedures that would provide for similar state relief or separate state determinations by addressing the following concerns:

- This bill does not specify whether the provisions of the bill would apply to requests for relief received prior to January 1, 2004. The bill should be operative for innocent spouse requests received on or after the effective date of this bill.

- Department staff recommends amending the bill to clarify that a requesting spouse that received relief at the federal level would be presumptively allowed relief at the state level to the extent that the issues and liabilities in question are the same. To the extent that the issues and liabilities in question differ, the state would be allowed to make the appropriate adjustments where California does not conform to the federal tax law provisions upon which the federal relief was granted.
- This bill would shift the burden of proof to FTB. Department staff suggests amending the bill to require the requesting spouse to provide FTB with the IRS determination letter, which outlines the type of relief granted, and all evidence submitted to the IRS that resulted in the determination to grant relief.

#### **FISCAL IMPACT**

The department's costs to administer this bill cannot be determined until the implementation concerns have been resolved. The inability under this bill to require the federal letter of determination to be included with a request for innocent spouse relief could cause FTB to expend considerable resources conducting independent investigations and gathering information.

#### **ECONOMIC IMPACT**

This bill would have a minor revenue impact. It is anticipated the revenue loss would be less than \$100,000 annually.

**Staff Recommendation:** Oppose, unless amended

**Status:** Senate Committees on Judiciary and Revenue and Taxation

(17)

**Bill No: SB 448      Author: Poochigian      Date: Introduced February 20, 2003**

**SUBJECT: Voter Registration Card With Mailing Of Annual Tax Forms**

**DIGEST:** This bill would require FTB to include a voter registration card with the PIT forms that are mailed annually to taxpayers.

**COMMENTS**

**Purpose:** To increase voter registration.

This bill does not specify the origin of the registration card. To ensure the correct information is included on the voter registration card, department staff suggests amending the bill to require SOS to provide the approved voter registration card to the Office of State Printing for inclusion in the binding of the PIT booklets.

The department mailed approximately 3.3 million PIT booklets for the 2002 tax year. However, the number of PIT booklets mailed is decreasing each year due to an increase in the electronic filing of tax returns. As a result, this bill may not reach as many potential voters as the author may anticipate.

**FISCAL IMPACT**

The department's costs to administer this bill cannot be determined until the implementation concern has been resolved. However, the costs to implement this bill could be significant if FTB is required to create, print, and bind the voter registration cards into the PIT booklets.

**ECONOMIC IMPACT**

This bill would not impact state income tax revenue.

**Staff Recommendation:** Neutral, if amended

**Status:** Senate Appropriations Committee

(18)

**Bill No: SB 516      Author: Speier      Date: Introduced February 20, 2003**

**SUBJECT: S Corporation Treatment Allowed only to Corporations with Less Than \$20 Million in Total Gross Receipts**

**DIGEST:** This bill would permit a corporation to be an S corporation only if its total gross receipts are less than \$20 million for the taxable year.

**COMMENTS**

**Purpose:** To prohibit large corporate taxpayers from being an S corporation for state purposes.

This bill would raise the following implementation considerations:

- The bill does not contain a definition of “total gross receipts,” and this term is not consistently defined for broad use in the Revenue & Taxation Code.
- This bill states that only corporations with total gross receipts of less than \$20 million are allowed to “elect” to be treated as an S corporation. AB 1122 (Stats. 2002, Ch. 35) provides that all corporations with a valid federal S election are California S Corporations. There is no longer a separate state election. This concern could be addressed by not revoking the California S status and by raising the measured tax rate of 1.5% to a higher rate for S corporations with total gross receipts in excess of a certain dollar amount.

**REVENUE IMPACT (In Millions)**

Fiscal Year	2003-04	2004-05	2005-06
Revenue Gain	785	655	705

**Staff Recommendation:** Neutral, if amended

**Status:** Senate Revenue and Taxation

(19)

**Bill No: SB 527    Author: Vasconcellos    Date: Introduced February 20, 2003**

**SUBJECT: Economic Development/Task Force**

**DIGEST:** This bill would create the Economic Development Accountability Task Force (EDAT). The EDAT would be comprised of members from various private sector groups and government agencies, including the executive officer (EO) of FTB, or his designee.

**COMMENTS**

**Purpose:** To create a system to gather and evaluate data regarding economic development in California in order to create new economic standards.

Chapter 12 to Part 6.7 of Division 3 of Title 2 of the Government Code already exists. Amendments have been provided to the author’s office to renumber the chapter to 13.

**FISCAL IMPACT**

It is anticipated that this bill would have a minor impact on the department.

**ECONOMIC IMPACT**

This bill would not impact state income tax revenues.

**Staff Recommendation:** Neutral

**Status:** Senate Governmental Organization Committee



(20)

**Bill No: SB 640     Author: Burton     Date: Introduced February 21, 2003**

**SUBJECT: State Agency Contracts/ Expatriate Corporations/ California Taxpayer and Shareholder Protection Act of 2003**

**DIGEST:** Under the Public Contract Code, this bill would enact the California Taxpayer and Shareholder Protection Act of 2003.

This bill would prohibit the state from entering into any contract with a publicly traded foreign incorporated entity or its subsidiary if all of the following apply:

(1) The United States is the principal market for the public trading of the foreign incorporated entity.

(2) The foreign incorporated entity has no substantial business activities in the place of incorporation as compared to the business activity of its subsidiary or subsidiaries.

(3) The foreign entity was established in connection with a transaction or series of related transactions in which:

- the foreign entity acquired substantially all of the properties held by a domestic corporation or partnership, and
- immediately after the acquisition more than 50 percent of the publicly traded stock of the entity is held by former shareholders of the domestic corporation or by former partners of the domestic partnership or related foreign partnership.

The chief executive officer of a state department or agency or his or her designee may waive this prohibition when a written finding has been made that the contract is necessary to meet a compelling public interest. A "compelling public interest" includes, but is not limited to, ensuring the provision of essential services, ensuring the public health and safety, or an emergency.

The bill would require each vendor submitting a bid or contract to certify under penalty of perjury that it is not an ineligible vendor.

### **COMMENTS**

**Purpose:** To prohibit the state from contracting with companies that are publicly held expatriate corporations.

The department has spent the past three years negotiating system requirements and working with industry to negotiate and award a contract to begin creating the statewide child support system. It is unclear what the impact of this bill would be on the statewide child support system.

It is unclear if the prohibition would pertain only to the company that is the primary source for the contract or if this bill would extend the prohibition to subcontractors or partners of the primary source. If the bill's prohibition extends to subcontractors or partners, this bill could hinder the department's ability to complete negotiations for a contract and could require the department to reinitiate the procurement process.

Reinitiating the procurement process would cause the state of California to incur additional substantial penalties imposed by the federal government.

This bill contains an exception that would allow the head of a state agency to make a finding that a specific contract is necessary in order to meet a “compelling public interest.” Situations that could be considered a compelling public interest are described broadly in the bill. It is unclear if the department could, if needed, exercise this option for circumstances unique to the statewide child support system.

Assuming this bill is effective and operative January 1, 2004, the language is silent on whether this bill is intended to apply to contracts awarded before that date. Absent clarifying language, the department would assume existing contracts are valid and would not be set aside. If, however, the bill is to be applicable to all existing state contracts, several significant legal concerns arise. These are discussed below under Legal Impact.

Article I, section 10, of the U.S. Constitution provides that “No state shall . . . . pass any . . . law impairing the obligation of contracts[.]” By its terms, this bill would impact future contracts and could be interpreted to apply to contracts entered into prior to the operative date of the bill, which could be unconstitutional. However, Article 3, Section 3.5, requires every administrative agency to enforce a duly enacted statute until an appellate court has determined the law was unconstitutional.

Article 1, Section 8, of the U.S. Constitution provides that “The Congress shall have Power ... to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes[.]” If enacted, this bill could be viewed as unconstitutionally discriminatory because it would prevent foreign corporations from being awarded contracts with the State of California.

### **ECONOMIC IMPACT**

This bill would not impact the state’s income tax revenue.

**Staff Recommendation:** Neutral, if amended

**Status:** Senate Judiciary Committee